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Tax Assurance: nexiology in taxation?

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Understanding Society

Tax Assurance: nexiology in taxation?

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Esteemed Rector Magnificus, dear colleagues, family and friends

1 Introduction

In this lecture I would like to introduce you to the field of Tax Assurance (TA). I will start with some background information on the start of the program at Tilburg University, followed by a definition and descriptions of the relevant elements of TA. I will then discuss the current state of affairs and I will conclude with my expectations on what the future will bring.

2 Background

In 2008 representatives of the big four accounting firms and the Dutch tax authorities asked the Fiscal Institute of Tilburg University to explore the possibility of incorporating TA in its master programs. The reason for their request was the increasing importance of TA in the practice yet the lack thereof in existing master programs. The request led to the launch of the profile TA in 2011, consisting of two electives (TA 1 and TA 2) and the possibility of incorporating TA in the master's thesis. From the beginning the program has been multi-disciplinary and this combined with its many guest lecturers from the practice (the Big Four and the tax authorities) have enhanced the program's quality and appeal to students. The profile was an instant success and is still currently running.

I have been involved in the program from the start as a coordinator and a lecturer and in my opinion the success of the TA program is to a large extent the result of the combined effort of the representatives of the Big Four and the tax authorities who requested such a program. In 2016 Deloitte and the Fiscal Institute of Tilburg University took the program one step further when together they founded the Tax Assurance Fund. The fund was established for the purpose of taking education and research in the field of TA to the next level. I am grateful to the founders of the fund and proud to chair the fund. In my capacity as chairman of the fund I will do my very best to fulfill its goals.

3 What is Tax Assurance

Although Tax Assurance is a relatively new term, assurance by itself is not. In the context of auditing it has a specific meaning. That is, an accountant can make an assurance report about something, most commonly a set of financial accounts drawn up by a company. The aim of an assurance report is to increase the user's trust in the underlying object of the report.

Apply this meaning to TA and it can then be viewed as something designed to increase the trust in the (correctness of) taxes in a specific case. Initially one can think of the position of taxes in the financial accounts of a company. We however view TA in a much broader spectrum: that is, anything to do with taxes within a company is within the field of TA. Thus, TA not only concerns itself with whether taxes in the financial profit and loss account and balance sheet are included for the right amounts, it also deals with the process of how these amounts were calculated, how the underlying data were assembled and processed and the dependability of the aforementioned data, the choices that were made in setting up the appropriate procedures, etcetera. The choices that were made should have been made in line with both the general and specific principles as laid down by the management and ultimately the board of the company. Another important element of TA in the broader spectrum as we see it, is the impact of the tax position in the financial accounts on, for instance, the public and the media.

TA is therefore a wide field of interest which involves many different scientific and practical areas. Strangely enough these areas are not taxation, apart from the content. I will elaborate on the most important of these areas in the next paragraph. This broad character of TA in combination with my fascination for Science Fiction led to the title of this speech. Nexiology is a term used by a writer, A.E van Voght, in a story called *The Wonderful Trip of the Space Beagle*. In this story a space ship sets out on a voyage to explore the universe. All categories of scientists are on board, each with its own department. The smallest department is the nexiology department and the resident nexiologist is the hero of the book. A nexiologist has no expertise in any specific field. He is an expert in integrating the different fields of science and come to solutions beyond the grasp of members of the separate fields of science. For this reason the established scientists do not take nexiology seriously. During the trip all sorts of dangers are encountered. While the traditional scientists cannot cope with the threats because they only know their own field, the hero, the resident nexiologist, can make the necessary connections and thanks to him the voyage is a success. I do not claim that TA is the answer to everything as nexiology is in the book, but there are certainly similarities in the sense that the combination of skills and knowledge is vital to confront the future successfully. Similar to nexiology , TA is about integrating different areas of knowledge to reach solutions for practical as well as theoretical problems.

4 What are the main elements in TA

4.1 Corporate governance, risk management, internal control, ethics

Generally the start for TA can be found in the principles the board of a company has regarding taxation. Good corporate governance demands that the board of a company performs risk management. This means they have to identify the main possible risks for the company and propose an instrument to deal with this risk (control it). Taxation is a main risk as it usually has a big impact on the financial accounts. The financial accounts are, amongst other things, a means for the board of a company to be accountable to its stakeholders. Issues with a potentially major impact on the financial accounts present a major risk and therefore should be dealt with by the board specifically.

So taxation is a possible risk and the board should manage this risk by controlling it. The other risks in the company must be controlled as well, so usually the company will set up a system for internal control. This internal control takes the form of a framework: a business control framework (BCF). Part of the BCF, the part that is concerned with taxation, is generally referred to as the Tax Control Framework (TCF). There are several possible frameworks. Probably best known is the COSO framework[1] that is under constant development. In building a TCF the initial input in the system is very important as it defines the outlines of the system. This initial input should be provided by the principles as laid down by a company's board.

In drafting principles a board will be guided by all sorts of things such as legislation and regulation, but ultimately the principles have an ethical core[2]; that is, how the board feels the company should behave[3]. An important aspect is what is known as the risk appetite of the board: to what extent is it willing to take risks on, for example, the regulatory and legislative front, but also with the media performance of the company. There are even separate frameworks to determine the risk appetite in more detail[4]. If the risk appetite of the board is to strictly adhere to the letter of the law in the pursuit of minimization of tax cost, this will lead to a different system than if the risk appetite is to avoid all conflict with tax authorities at all cost.

[1] See the new exposure draft of June 6, 2016 *http://www.coso.org/documents/COSO-ERM-Exposure-Draft-061416.pdf*, for earlier reports and models: *www.coso.org*.
[2] See Happé, Multinationals, handhavingsconvenanten en fair share, in Per Saldo, Overheidsfinanciën en fiscaliteit na twaalf jaar minster Zalm, SDU, 2007, section 5.9 (p 72)
[3] See Tax Assurance (ed. Russo) 2015, Kluwer, Chapter 4.
[4] See the Institute of Risk Management, *www.theirm.org/media/464806/IRMRiskAppetiteExecSummaryweb.pdf* for a report on the determination of risk appetite.

At this point, I would like to stress that the responsibility for creating the principles for a company, including the tax principles, lies with the board. In the past, taxation was regarded as a complex, detailed area in which neither supervisory boards nor management boards had any interest. The tax department handled all tax affairs and that was the end of that. In such a setting it was quite possible that the board would also leave the matter of tax principles to the tax department. This is not as it should be. Indeed, the tax department should make sure that the principles are adhered to in the day-to-day practice but it is not its responsibility to actually draft them. Obviously because of a tax department's detailed knowledge in the field, it could and, in fact, should be involved in the drafting process. This involvement should consist of supplying the information on, for instance, the state of the various parts of the company, current and expected legislation, available information on other companies in the market, available guidance, etcetera[5].

So corporate governance and as part of that risk management and internal control are important elements of TA. Ethics play an important part in forming the tax principles and through them the input for the control system. The principles are really about behavior and express the behavior the board would like to see. It is in itself difficult to change behavior. You can punish bad behavior or reward good behavior or have a combination of both. You can nudge or you can shove. Ideally you would like the principles to be internalized so that people abide by them not because of sanction or reward, but because they intrinsically feel it is the right thing to do (intrinsic motivation). In this sense all other ways to get people to comply are second best and a means to achieve voluntary compliance (extrinsic motivation). It is also important to note that internal control is part of good governance for the board (in that it has control), it is a good thing for the stakeholders (because internal control can enhance the accountability) and it is advantageous for the regulators (as there is more (voluntary) compliance).

Part of having an internal control system is that is has to be monitored. In practice the system has to function properly and this must be checked. It is not enough to write down all the procedures and implement the system. Constant monitoring is required to make sure that the system works, that the input is right, the output reliable, etcetera. Some view monitoring as the last step in implementing an internal control system. I tend to see monitoring as supervision. The difference between these two views is theoretically very significant. That is, if monitoring is implementation, it is a board responsibility. If, however, if monitoring is supervision, it is a responsibility of the supervisory committee or

[5] Such as the guidance of the CBI, see *www.cbi.org.uk/media/2051390/statement_of_principles.pdf* or Good Tax Governance in Transition, www.vbdo.nl.

non-executive directors. In each view the internal audit which is probably the department that actually carries out the monitoring function will primarily report – and therein lies the aforementioned significant difference – to a different person[6]. I will come back to this point in paragraph 5.

4.1.1. What should the control focus on?

An important issue is whether the control should be compliance based or result based. This really is a core issue because it requires us to define what is the main purpose of control. On the one hand, the board must be in control so it can steer the company. It must have sufficient information and input to decide whether the company is going in the right direction or needs a course adjustment. On the other hand, many regulators, tax authorities amongst them, want companies to be compliant. In theory, both points of view should lead to the same measure of control, but in practice the difference in emphasis could lead to different systems and different levels of control.

Regulators are generally interested in internal control because they want to rely on it as much as possible in their supervision of a company. If regulators can rely on the internal controls of a company there is no need for them to (completely) audit themselves. For regulators the internal control is ideally based on compliance. In the case of taxation this entails filing the appropriate tax returns, paying taxes due, fulfilling any and all other obligations and do all this correctly and on time for all taxes. For a company the result counts: can the board declare that it is in control, and do the financial accounts give a true and fair view of the company?

For bigger companies the accounts must be audited by an external accountant. For the accountant this is an assurance report: it is designed to increase the trust of users of the financial accounts. In his audit the accountant, like the regulators, will review the internal control system as part of his audit plan. The criteria of the accountant differ from those of the regulators, more specifically the tax authorities. The main differences are materiality, national versus international, SME's versus big companies, and different criteria for tax and financial accounting.

Materiality: an accountant does not correct all the faults he finds. If the fault does not have such an impact on the financial accounts that a user of the accounts would change his opinion if it were corrected, the fault is not corrected. With bigger companies material-

[6] See Voorstel voor Herziening van de Nederlandse Corporate Governance Code, *www.mccg.nl*, principle 1.2: Risicobeheersing, in which the internal audit is looked at in detail and my comments in more detail in WFR June 2, 2016, no. 7147, pp. 787-791.

ity can be quite high in absolute numbers as it is usually a percentage of their turn over or equity. In taxation materiality as such does not exist. All faults found must be corrected.
National versus international: financial accounts are usually consolidated accounts and contain all subsidiaries national as well as international. By contrast, taxation is usually based on single accounts and always limited to one jurisdiction. Although taxation can also be based on a consolidation of a group of companies, in these cases the group is usually not the same as it is for the financial accounts. The scope of tax authorities is principally based on a national tax system. The consolidated accounts of an international company are therefore not always useful for taxation purposes. Another difference is that companies in their organization tend to look at divisions and shared services centers etcetera, without primarily taking notice of borders between states or legal entities. The reporting architecture is then not always usable for tax purposes or at least not without significant adjustments.

SME´s versus big companies: in big companies, the ownership and the management of the company are usually not or only to a certain extent related. This is an important check and balance. The board of the company is accountable to the owners, i.e. the shareholders, and shows this accountability through the (financial) accounts and the audit of the accountant. When management and ownership are related or even identical as is the case in many small and medium-sized companies, this check and balance does not work. If there is no audit by an external accountant (and an external audit is generally not compulsory for SME´s), the accounts are even less trustworthy to stakeholders other than the shareholder. Tax authorities are a stakeholder as part of the government[7].

Different criteria: for taxation purposes a company must comply with all obligations from the relevant tax laws. In corporate income tax the tax base is the taxable profit, which is usually not the same as the profit for financial purposes. In The Netherlands, the tax base is governed by what we call 'goed koopmansgebruik', while for financial purposes IFRS or national GAAP applies. Although there are differences between these sets of criteria, there are similarities too. For example, the amount of goods sold, costs etcetera are principally the same. Sometimes for tax reasons exemptions will apply or special rules for depreciation or non-deductibility of certain cost. These exemptions and special rules lead to timing differences or fundamental differences (often referred to as book-tax differences) between the taxable profit and the profit for financial accounting purposes. An audit for financial accounting is therefore usually not unconditionally usable for tax purposes[8].

[7] See Tax Assurance (ed. R. Russo), Kluwer, 2015, Chapter 7.
[8] For a detailed international analysis see Freedman, Financial and Tax Accounting: Transparancy and Truth, in Tax and Corporate Governance (ed, W. Schon), 2008, Springer

When one considers all the differences between financial accounts and tax accounts, the inevitable conclusion has to be that financial accounts can be valuable for tax accounts or the audit thereof, but they cannot as yet replace them. The challenge for tax authorities then seems to be how to use financial accounts and the work performed in the drafting and auditing of them to help reduce the work involved in a tax audit.

4.2 Audit

The term 'audit' has already been used a lot. The aim of an audit report is to provide a reasonable level of security or assurance that the object of the audit is free of material mistakes. It never, however, provides certainty.

Audit is a separate field within accountancy to reasonably ascertain that the financial report that is audited, presents a true and fair view. This auditing of financial reports is done using certain techniques and tax auditors use a lot of the same techniques to ascertain whether or not the tax accounts comply with the tax regulations[9]. This is not a big surprise as both type of auditors want to be able to form and express an opinion on a report. The only difference is that the criteria for profit calculation are not identical (see 4.1.1.). To put it bluntly: both financial and tax auditors want to ascertain whether the accounts contain all income and all cost relating to the reporting period. Both auditors will look at the internal control of the company and determine how much factual checking they will do themselves. The more they can rely on the internal control, the more they can reduce the time and effort needed to conduct their own checks[10].

If I focus on taxation, the internal control has been formed in the shape of the TCF. There is however no legal or regulatory framework for a TCF in The Netherlands[11]. The tax authorities have taken the position that a TCF is not there for their benefit of them, but is there for the board as a means to be in control. According to them the TCF is entity specific so a framework is neither possible nor necessary. The accounting organizations have also not or at least not yet developed a framework or other type of regulation concerning a TCF. In other jurisdictions there are developments, legal or otherwise. An example of such developments on a national level is the Tax Risk Management and Governance Review

[9] See Tax Assurance (ed. R. Russo), Kluwer, 2015, Chapters 14 and 15.

[10] See Controleaanpak Belastingdienst, *http://download.belastingdienst.nl/belastingdienst/docs/cab_dv4221z1fd.pdf*

[11] There is no formal regulation but there are publications by the Dutch Tax Authorities, such as the Leidraad Toezicht MKB that contain some guidance: *http://download.belastingdienst.nl/belastingdienst/docs/lei_hor_toez_mkb_branche_dv4081z1pl.pdf* en Leidraad Toezicht Grote Ondernemingen: *http://download.belastingdienst.nl/belastingdienst/docs/leidraad_toezicht_grote_ondernemingen_dv4231z1fd.pdf*

Guide by the Australian Taxation Office[12], while on an international level, the OECD published a paper on the possible outline of a TCF[13].

If formal regulation for a TCF were in place, it would be easier to determine the value of a TCF for an audit. The reluctance of, amongst others, the Dutch tax authorities is that regulation would lead to 'tick the box' behavior. They fear companies would meet the (minimum) requirements as set out in the regulation and then expect reduction in audit activity where the actual level of compliance might not justify this. That said, other jurisdictions do have legal guidance at this point so they obviously do not share the aforementioned fear. Ultimately every 'translation' of a standard into a regulation will bear the risk that the regulee will modify its behavior not according to the spirit of the standard, but to meet only the wording of the standard. To exclude this risk, the quality of the regulation should be so high that complying to it automatically means complying to the spirit of it (or at least complying to it as much as possible).

In my opinion formal, detailed guidance for a TCF will be hard to achieve in practice. In theory an assurance report on the TCF with a materiality that is acceptable for tax authorities might be a solution. For an auditor to actually be able to deliver such a report at an acceptable price is currently not practically feasible.

4.3 Relationship with Tax Authorities

Companies have always had an uncomfortable relationship with tax authorities. Commercially taxes are cost and in general cost are to be kept to a minimum. But then there is the legal obligation to pay taxes. In the not too distant past, company policy on taxes was usually to pay the least possible within the limits of the law. The letter of the law was leading: if it is not prohibited, it is possible and if it is possible why not do it. Maybe there is even an obligation for the board of a company to pay the least tax possible as a part of good governance. In recent years the notion has developed that companies should also take another aspect of taxes into account: it is a very important means for governments to finance their policy, such as a working infrastructure, police, hospitals, etcetera. If nobody would pay taxes, the infrastructure and indeed civilization as we know it would change. This, in turn, could lead to a decline in demand for the products of the companies. It is therefore also in the interest of companies that each pays its fair share of taxes. The problem then, as opponents of the concepts always like to point out, lies in

[12] See *www.ato.gov.au./Business/Large-business/In-detail/Key-products-and-resources/Tax-risk-management-and-governance-review-guide/*

[13] See *http://www.oecd.org/publications/co-operative-tax-compliance-9789264253384-en.htm* and comments on it by Lisette van de Hel-Van Dijk in Vakblad Tax Assurance, September 2016, p. 25.

further defining what this fair share exactly is. The relevant tax laws are principally how the legislator has defined the fair share. Ideally, these laws should be so simple and clear that there would be no reasonable doubts as to the application of them: letter and spirit of the law should be the same. Unfortunately in the practice as we know it this is not (always) the case. Legislation is always a battle between providing legal security and doing justice to all individual cases. Real life is often complicated, and so too are tax laws, which follow the complexity of the underlying issues. Another complicating factor in this respect is the fact that jurisdictions compete with each other to attract investments. This competition is also present in the field of tax laws.

So what does this mean for the relationship companies maintain with tax authorities? Companies are not clients of tax authorities (paying taxes is mandatory and not a choice) and they are usually not equal parties in a legal sense. Tax authorities have legal powers (such as the right to audit) to balance the fact that companies have more knowledge about their own commercial processes[14]. In the past this has led to a vertical cops and robbers relationship, but in the last decennium this has slowly changed. Tax authorities and companies have come to the conclusion that they have a lot in common and they should explore the similarities rather than fight over the differences. Fighting, disagreeing on the tax consequences of transactions or other facts, cost on both sides. A tax audit is costly for the tax authorities, but also for companies which have to commit internal and external resources to this process. Moreover, the audit usually focuses on the past with all its subsequent difficulties.

The new way in interaction between companies and tax authorities is to go from the vertical cops and robbers approach to a more horizontal approach of greater equality and a situation of (funded) trust. In this new relationship they both share information as soon as possible, so no waiting until the tax return, and try to find a joint solution if possible. If a joint solution cannot be found, they agree to disagree on a specific point and ask a third party opinion, for instance a judge. This point should be a one of interpretation of law and should not be about facts and should not burden the relationship as such. So an audit term such as 'detection risk' should not be relevant here[15]. Such a relation has been referred to as horizontal monitoring, enhanced relationships and most recently cooperative compliance[16]. In The Netherlands, when the tax authority and the company adopt

[14] See Stiglitz, The roaring nineties, W.W. Norton and Company, 2003, New York and Happé, Contractvrijheid, (ed. Hartlief en Stolker), Kluwer, 1999.

[15] Internationally see *http://www.oecd.org/publications/co-operative-tax-compliance-9789264253384-en.htm*.

[16] For more information see Tax Assurance (ed. R. Russo), Kluwer, 2015, Chapter 6.

this new way of interaction, they formalize their relationship with a covenant[17]. There is an ongoing debate whether this is a contract for private law purposes or (just) a gentleman's agreement. As in the covenant the company commits to sharing information actively with the tax authorities, for which there is no legal basis, I personally think the covenant is a contract that can lead to obligations for both parties involved.

A major advantage of cooperative compliance for the company is that it has more certainty on its tax position in the financial accounts. Especially the provision for uncertain tax positions will under cooperative compliance be limited to cases of agree to disagree. The relationship between the company and the tax authorities will be a continuous dialogue in which most uncertainties will be dealt with. The position of taxes in the financial accounts will be more secure, so there will be more assurance. In short, cooperative compliance can be a tool for risk management and can lead to better control of the tax obligation.

Another positive aspect is that companies or the public might view participation in cooperative compliance as a sign of a certain quality standard. Companies can place their relationship with the tax authorities in the realm of Corporate Social Responsibility (CSR)[18] and, for instance, place it on their website. This might in a general way have an impact on the media presence of the company.

The advantage of cooperative compliance for tax authorities is that they have less work in processing tax returns because these will contain no surprises. The focus is on the here and now in cooperation instead of the past on the basis of audits. A possibly negative issue of cooperative compliance for tax authorities is that they have to invest more in the relationship with the companies. This will mean a shift in the way they work and will probably lead to additional training for the people involved. Thus far, the balance for the tax authorities seems to be positive although there is no empirical evidence yet to support this.

An assumption to enter into a cooperative compliance agreement is that the company is in control of its tax obligations or is willing to work towards such control. In other words, the quality of the TCF should be adequate. The TCF of the company and the assessment of it by the tax authorities therefore is key to the concept of cooperative compliance. If the tax authorities are involved in the actual building of the TCF there is true cooperative compliance.

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[17] See: *http://download.belastingdienst.nl/belastingdienst/docs/leidraad_toezicht_grote_ondernemingen_dv4231z1fd.pdf*

[18] See Gribnau/Jallai, Good tax governance and transparency: a matter of ethical motivation, SSRN-id278.120Shansenave.pdf, point 7 where the issue of CSR and taxes is discussed.

As mentioned in 4.1.1. there is a difference in internal control for SME's and big companies. With SME's the TCF often lacks some of the checks and balances that are present with big companies. This does not mean that cooperative compliance is as a rule not applicable for SME's, but it does mean that another approach might be useful. In The Netherlands there is a special program for SME's in which the intermediaries (generally accountants) play a major role[19]. Essentially the inherent weaknesses in the TCF of an SME are supplemented by the quality system of the accountant of that SME. The tax authorities asses the system of the accountant who can, if the assessment is positive, then apply to be an intermediary for SME's. This is formalized in a contract between tax authorities and intermediary. If an accountant has a client which he feels is ready for cooperative compliance, he can submit this client under the contract he has with the tax authorities. For the company the advantage is that its advisor is in direct communication with the tax authorities and that an audit is therefore less likely. The advantage for the tax authorities is that they receive tax returns that have been subjected to a quality control system and need little attention. Instead, the tax authorities can focus their audit on meta supervision: they will select some accountants and audit the returns that have been filed for their clients.

For the assessment by the tax authorities to admit an intermediary it is very important that the accountant has a quality control system that is subjected to some form of external supervision. Many accountants are members of a professional organization which can organize such external supervision. For accountants who do not have such a network, it is in practice difficult to be admitted as an intermediary. In my opinion the accountant that wants to be an intermediary should be able to show his quality system is adequate, regardless of whether he is a member of a professional organization.

There are many issues under cooperative compliance that are still unclear. An example of this is the fact that a company that does not meet its tax obligations can be faced with penalties. Tax authorities usually have some discretionary room in the application of penalties to do justice to individual cases. If a company that has entered a cooperative compliance arrangement incurs a penalty, will the fact that there is cooperative compliance affect the penalty? Will it be a reason to increase or decrease the penalty? Both are possible. Ultimately this will become clearer as disputes arise and case law will appear.

[19] See: *http://download.belastingdienst.nl/belastingdienst/docs/leidraad_horizo_toezicht_fiscaal_dienstverl_dv4071z2pl.pdf*

4.3.1. State Aid

A new element in this field is the State Aid discussion[20]. If a company has an agreement with a tax authority, this should lead to maximum tax assurance on that particular point. The tax authorities have committed themselves in an agreement (usually in a ruling of some sort) to a certain tax treatment of a certain event under certain conditions. The details will be dealt with in the ruling. Provided the company follows the ruling and meets the conditions, the treatment should be clear. The European Commission (EC), however sees this differently. It maintains that a certain tax treatment could be classed as State Aid. In those cases the EC can force the state involved to reclaim the advantage that it classes as State Aid. For the company it would mean that, although they have tried to reach maximum TA, i.e. a signature of a tax authority, they are still liable. Technically the liability is not tax, but State Aid to be repaid. I wonder whether the company having to pay back State Aid could claim breach of contract (the ruling) by the state in question and have their damage covered. At the moment several cases of State Aid are being challenged by states and companies so the end result is not yet clear.

4.4 Content of material and procedural law

As mentioned before the TCF contains the internal control system to comply with the tax regulations in its broadest sense. The regulations are found in the relevant tax laws, both material and procedural. The material laws are concerned with regulations on how to calculate the taxable profit, turn over or transaction and how to file this in an appropriate tax return. The procedural laws contain the rules for objections, legal procedures, audits and other obligations. This is the input for the internal control system and indeed often in drafting a TCF an advisor will start with the legal requirements (from the relevant law). I said at the beginning that most of TA is not about tax as such, but this is the part on the content of the TCF which consists of the actual tax regulations.

One of the problems is that the TCF should include all taxes. The most important taxes in terms of numbers are corporate income tax, value added tax and wage taxes. In addition there are property transfer taxes, local taxes, excise duties, environmental taxes, etcetera. Further more, the TCF should be implemented for all subsidiaries in all jurisdictions. So it is not just the multi-disciplinary nature of TA that makes it a team effort, it is also the content that is too much and too divers to be dealt with by one person. To make the job of drafting a TCF practically possible, it is usually further divided in a system per tax or

[20] Companies such as Starbucks, Apple, FIAT and more recently MacDonald's, Amazon and Ikea have been granted (forbidden) State Aid, according to the EC. For more detailed information see Smit, BEPS en het Europese arm's length beginsel, WFR august 25, 2016, p. 1084 – 1054.

category of taxes. The different taxes all have their particular requirements that shape the way you can be or can try to be in control. An example is the fundamental difference between corporate income tax (CIT) and value added tax (VAT). CIT is a tax on the profit of a company over a given period, usually a financial year and the return is usually filed after the financial year has ended. There is therefore time to make adjustments if necessary. VAT is a transaction tax and the return is filed on a monthly basis. Control in VAT is focused on whether the VAT on outgoing invoices is correctly calculated and whether VAT on incoming invoices is processed properly. These are usually automated systems with many transactions. There is not much room for adjustments: a mistake in the system leads to an incorrect invoice and unless this is discovered before the invoice is sent to the client adjustment is in practice hard to achieve. TA in VAT is therefore usually closer to the administrative processes of the company and focused on monitoring the output.

4.4.1. Fair Play

As I mentioned before, there is a difference between the position of tax authorities and that of companies. Tax authorities have extensive legal power to perform their function. This power is rooted in formal law and basically entails that companies have to answer questions by tax authorities and have to allow audits. This power has the purpose to counterbalance the factual knowledge advantage of the company: it knows what it is going to do and what goes on internally and internationally. The difference in legal power is the main reason that the relationship between a company and a tax authority can never be truly equal not even under cooperative compliance. There are however limits to the legal powers of the tax authorities or more specifically on how they can exercise their powers. In the Netherlands the Supreme Court[21] ruled that fair play dictates that a company has to provide the tax authorities with all information except when (part of) the information is advice about their own tax position. A tax advice to the company does therefore not have to be provided. In practice it can be difficult to decide specifically what falls under the 'protection' of fair play. The audit file of the external accountant for instance is not as a whole forbidden territory to the tax authorities, but part of it may well be. There is some guidance on this from the NBA (the Dutch Accountants Organization) which can be applied to most cases[22].

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[21] See Supreme Court September 23, 2005, BNB 2006/21 n.c. Wattel, m.n. De Bont.

[22] Handreiking 1113, *www.nba.nl/documents/Tools%20Vaktechniek/NBA-handreikingen/1110-1119/NBA-Handreiking_1113_Inzage_in_de_controledossiers_van_de_openbaar_accountant_door_de_Belastingdienst_Vapril-16_(layout).pdf*

4.5. Developments in society

The outlook of society on the subject of taxation has altered in the last decade. I already mentioned this in describing the relationship between tax authorities and tax payers. In general there is a tendency to be more transparent and to be accountable in more ways than just financially. The opinion of the public is something companies increasingly take seriously, although this is not necessarily a good or dependable development. An example is the Starbucks case, where there was a (brief) buyers boycott because Starbucks did not pay enough tax. I cannot help but wondering what would happen if they announced that they would increase prices to finance the paying of taxes. There might be a boycott again but for different reasons. Another point is that companies which do not (directly) supply private customers are less vulnerable to public opinion, a difference that does not seem balanced. So the public opinion is not always a fair or dependable factor which makes it hard to deal with. In contrast: revelations by more serious media as a result of investigative journalists (Panama Papers, Bahama Papers) are a welcome addition to the field of transparency[23].

Transparency is also an issue for (institutional) investors. In a report Schroder concluded that Apple might not be such a good investment because its tax policy is not sustainable[24]. Perhaps the voice of investors will be stronger than the voice of the public in general since the former's impact on share value is potentially higher.

Internationally the OECD and EU have their own plans regarding taxation: more transparency and less BEPS. I would like to add that this will in my opinion only work if there is international coordination instead of competition between states. To gain a higher level of TA boards of companies will have to take these developments into account. They might adjust their policy and/or risk appetite and this will have its impact on the TCF. For example, suppose that a certain tax structure is possible legally and will lead to a tax saving, although it is not entirely sure whether it is in line with the spirit of the law. Should the board implement this structure or should they take the spirit of the law into account? Another way of looking at this problem is to view the long term effects and costs. If the structure does not comply with the spirit of the law, the relevant legislator might change the law and the structure will possibly loose its advantages or it may require additional costs to adapt. This might also lead to the decision not to implement the structure although it is possible legally. These are extrinsic motivations that will hopefully (one day) lead to intrinsic motivation.

[23] Such as the international consortium of investigative journalists, who are (co)responsible for the Panama Papers and most recently the Bahama Papers, for more information see *www.offshoreleaks.icij.org*.

[24] See *www.schroders.com/en/uk/tp/article/?id=a0j5000000BF05sAAD*.

5 Where are we now?

In order to gain an understanding of where we are in the current developments in TA I will go through some of the steps necessary to build, implement and maintain a TCF, in essence a summary of my earlier remarks.

- *Principles:*

The first step is to ensure the input for the system; in other words, determine the tax principles. If the company does not have any, or they are not explicitly put on paper, they should be made and recorded. This is a board responsibility, but they will probably need input from the tax department on detailed areas. It is vital that the principles are in line with the general principles and with specific principles on other subjects if applicable. The principles should be something to strive for, but if complying with a specific principle is not always possible under all circumstances (which is usually the case), this could be included. If it is a work in progress, this should be reflected in the wording. Corporate governance rules demand principles but they do not explicitly demand that they are public. I think that the principles should be public, so the stakeholders can measure the performance of the company against its principles. In that sense I believe it is vital information for the stakeholders. Tax authorities increasingly take an interest in a company's tax principles. Even if these are not public, tax authorities can always ask for them and currently in some jurisdictions already use them or plan to use them in for instance access to cooperative compliance. A good example is the UK, where a report by the tax authorities reveals the importance of principles for tax compliance[25].

- *Some characteristics of principles:*

In The Netherlands and the UK principles are usually public and can be found on the websites of companies[26]. US companies that are in the news with tax issues usually do not have public principles. Generally published principles contain the wish to comply to the relevant tax laws, for tax to follow the business, to have a working relationship with tax authorities and to respect the spirit as well as the letter of the law (not always). A remarkable point is that some companies feel free to use tax incentives if jurisdictions make these available. An example of such an incentive is the existence of an IP or innovation box in a certain state (essentially a subsidy to attract certain investments hidden in tax laws). In these cases tax does not always follow the business, but apparently the fact that the jurisdiction facilitates this behavior makes it justifiable for the company. It is difficult to argue that this is not right and it supports my claim that incentives should be dealt with

[25] Report of HMRC, Exploring Large Business Tax Strategy Behaviour, July 2015, *www.gov.uk/government/publications/exploring-large-business-tax-strategy-behaviour*.

[26] See in more detail Russo, Fiscaal Beleid en Corporate Governance, TFO January 2015, no. 136.

supra nationally. Another important issue is that in my opinion the tax department should be a staff department and not a profit center[27]. The tax department as profit center is not reconcilable with the principles mentioned above (especially not with the principle that tax should follow the business).

- *Identifying risks per category of taxes:*

CIT: recording of the data processes, adjusting the data for tax purposes (differences book-tax), identifying events that might trigger tax liability or tax saving possibilities, etcetera;- VAT: recording of incoming and outgoing invoices, reviewing the correctness of VAT on them if applicable, identify events that might lead to problems or possibilities, etcetera; Wage taxes: follow personnel from hiring to firing, check incentives and expenses for wage tax consequences and make sure that all relevant (administrative and legal) details are met

From this sum up it is evident that taxes are connected to all other parts of the company. CIT is closely related to the financial accounts (the finance department), VAT is more connected to sales and procurement, wage taxes belong in the field of human resources and so on. The tax department must therefore be connected to all departments.

- *Implementing an internal control system (hard and soft):*

To control the risks a control system must be implemented. It is important that this is not just a handbook in which all procedures have been written down. It should be carried by all people involved, especially management, so that it is always used. The control system should also take into consideration soft controls. People working with it should have an environment in which they can safely comment on the system and stop if a fault has been detected even if this is commercially not attractive at that particular time. It is the responsibility of senior management to create this environment. One of the ways they should attain this, is to lead by example.

The extent of automatization is important on many levels. In the recording cycle many data are recorded, but not all are available in a structured format. Especially in the case of a multinational company with many subsidiaries and its many investments and divestments every year, not all systems applied will be compatible. To structure these data so they can be processed properly is a problem for the financial recording and reporting, but also for the tax recording and reporting. Another aspect of IT is the input for automated administrative processes in the company, an example of which is the invoicing. The input

[27] This issue specifically in the VBDO publication 'Good Tax Governance in Transition', guiding principle 2.

should lead to correct invoices for VAT purposes for all possible situations. A last aspect of IT can be found in its monitoring function. Traditionally this is done by sampling, but there are many new IT based techniques such as data mining and the new techniques will largely replace sampling eventually.

- *Monitoring the working of the internal control system:*

Monitoring whether the system functions properly can be viewed as the last step of the implementation of an internal control system. It can also be viewed as supervision of the system. I tend to the last point of view. Assessing a system is preferably not done by the same persons who implemented the system. Therefore in my opinion monitoring, which is generally done by the internal audit, is a form of supervision. If the monitoring leads to the discovery of weaknesses or faults in the system, these faults should be corrected. More importantly, the system should subsequently be amended in order for the fault or weakness to be eliminated from the system.

In practice there are several problems associated with monitoring. In the first place it does not always happen. Companies implement a system and that is it. Obviously any change - and in taxation there are many changes every year such as applicable rates and changing legislation - must be reviewed to decide if and if so how the system should be adjusted. If this does not happen, the system is no longer adequate. Another problem is that the internal audit does not always have the necessary tools to monitor the TCF. This is a matter of supplying sufficient funds to internal audit so they can function on a satisfactory level. This means that internal audit should not only have enough personnel but should also have the funds available to get a second opinion from a third party, if the situation so requires. To take this one step further: I think internal audit should report primarily to the supervisory board. For internal audit to report to the board which is also subject to their audit is in my opinion a weakness in the system.

- *Adjusting the internal control system if the monitoring reveals flaws in the system:*

It seems obvious that the internal control system is amended in case flaws are discovered. In practice, however, there can be many, often commercial, reasons not to amend the system at that particular point in time. I can imagine that the report of the internal audit can be very interesting literature for any external auditor, such as an external accountant or a tax auditor. If a company has entered into a cooperative compliance agreement with tax authorities I think there is no doubt that the report should be discussed. I think this would be a good way for a company to show its level of control. It shows its weaknesses, but also its reactions to the weaknesses, which I think shows strength and builds trust.

- *Making sure that tax is connected with all business decisions*

Apart from getting the process of taxes in the business right I would like to stress this point separately. When a business decision is made that has potential tax consequences, these consequences should be considered, including the possible media exposure the aforementioned consequences may entail. If for example the board of a company intends to acquire another company, the tax principles of this last company should be brought in line with those of the new parent company. If the tax principles are not in lines with those of the parent company and questions are asked in the media, the board should be prepared to answer these, for instance: we know that currently the tax principles are not in alignment with the parent company's, but we plan to change this. Before the board makes such a statement, it has to be certain that alignment is feasible. If it is not possible, maybe the acquisition is not a good idea. The strategy and choices should be clear prior to the investment.

- *Management control*

Usually there are different systems for management control and financial control[28]. I talked mostly about financial controls. Management control focusses more on key performance indicators (KPI) and how to manage them. If the profit is a KPI for a manager and relevant for his bonus, he or she has an interest in profit levels. As tax are a cost commercially, there is consequently an interest in the level of taxation. This might induce managers to minimize (tax) cost in a way that is not in line with the tax principles of the company. The board has to recognize this and deal with it. This might mean adopting a different KPI or have an extra control on the calculation of the profit, for instance by the internal audit. In general I think that the board must be aware of the consequences of their management control system and control these consequences accordingly.

6 Where will we be in years to come?

The world is changing and taxation will be changing with it. This is nothing new. It is harder to think of the actual form these changes will take and their influence on taxation and TA in particular. Nevertheless, I will make an attempt and when I end my scientific career I can compare with the situation as it will exist then.

- **IT:** an easy trend is to predict that IT will continue to develop. However, the concrete influence of those developments on taxation and TA is harder to imagine. Certainly data

[28] See for a discussion on the tax perspective and the management control perspective on a specific subject (transfer pricing) Tax Assurance, chapter 13.

will be more and more structured: they will be available digitally. Taxation will be more and more viewed as a process with input of data to lead to output: a tax return or some other report. There already exists a strong link between financial reporting and tax reporting. Many data from finance form the basis for the data for taxation. I believe that technology will enable companies more and more to integrate tax in their financial data so that manual adjustments will become less needed and eventually not needed at all. So technology will have an impact on reporting, but also on monitoring and controlling the input for the systems. The work for tax experts will shift to the input side and architecture of the IT systems where taxation is concerned. The output will be much more automated and subjected to automated monitoring techniques. Tax experts will in my view always be needed to solve the problems the systems identifies.

- **Convergence of financial and tax criteria:** the integration of tax data with financial data will be easier if the criteria for calculating the financial and the tax profit have the least possible differences. Currently there are many differences between the financial and taxable profit leading to many inefficiencies. The good news is that converge of both sets of criteria is possible without too many problems because there exist already many similarities between them[29]. The bad news is that the difference in purpose between the financial and the tax accounts in the opinion of many make the convergence not desirable. I hope that both sets of criteria will converge as the problem of differences in purpose only exits in certain areas. For the moment, these differences can remain, for instance, differences in pure tax measures such as participation exemption or commercial revaluations through other comprehensive income. Obviously the concept of materiality, which does not exist in taxation, will also remain a problem to be solved. At this point technology too can play an important part. The audit files will contain a lot of information on the faults that have not been corrected for lack of meeting the materiality criteria. This information should find its way to an adjustment for tax purposes. As far as the internal controls are concerned, the same applies to the reports of the internal audit. These reports should also be shared with the tax department and it, in turn, should probably share the reports with the tax authorities, especially if some form of cooperative compliance is applicable.

- **Supranational coordination**: I think tax competition between states is not healthy as it will ultimately lead to erosion of income from taxation for these states. This competition can only be solved if coordination takes place on a higher level. Many of you know that I like Star Trek, also from a tax point of view: a world government with a global tax system that would decide on a global scale where help (if necessary in the form of

[29] See Rapport Vereniging voor Belastingwetenschap no. 254: GKG Quo Vadis

limited taxation but preferably in the form of subsidies) is needed. A good starting point practically would be to have a common tax base in the EU, for which a draft directive already exists. If it would also include the rate (or at least a minimum) competition with taxes between member states of the EU would be very limited[30]. Evidently it cannot be more than a starting point if other jurisdictions do not join the common base. This common base, with reference to the previous point, should be as close as possible to the commercial rules for calculating the profits[31].

- **Transparency**: Coordination and technology will both make transparency more and more the norm. Although this is in principal a good development, it does have its darker sides. Companies should be able to minimize their cost, including their tax cost, as long as there is no artificial aggressive tax planning involved. Normal tax planning, that is, the avoidance of double taxation, should not be treated in the same way as artificial aggressive tax planning or be viewed as such by a public/ media that sees everything due to transparency but is not always able to tell the difference[32]. It is easy to bash all multinationals and their advisors in general but this could be counterproductive for those companies and their advisors that do not actively seek aggressive tax planning. In a transparent world the principles of the company and the way the board treats these principles will become more and more important.

- **Possibilities of people**: our challenge now is to train people, tax experts, in TA, and give them the tools necessary to face current problems. In the future people will be educated straight away in TA and I am sure they will think of things that I now am not able to come up with. They will be trained to think in a multi-disciplinary way from the start, they will have knowledge of IT and taxation and will be able to combine this all. Like many of you, I myself have been educated in the traditional way too and although I know something about TA I think I may have restrictions they will not have. Axiomatically I do not know what this is, I just expect it to be there.

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[30] Although it is difficult to agree on a joint approach because there is a lot of distrust between member states (see Financieel Dagblad april 14, 2015, there is also a proposition by France, Germany and Italy on a minimum corporate income tax (see Financieel Dagblad may 27, 2015). There is however no official amendment to the draft proposal for a common tax base (yet).

[31] It is not just the EU or the OECD that call for coordination, the IMF has the same remedy, see the IMF Policy paper of May 9 2014, Spillovers in international corporate taxation.

[32] See Essers, Aggressive tax Planning, international tax justice between Machiavelli and Habermas, Bullletin for International Taxation, February 2014.

- **Research**: the research will focus on the areas that have been mentioned above. Concrete current subjects are case studies into the actual application of internal control for taxation, cooperative compliance in SME's, technological changes in audit techniques specifically for taxation (data analytics and mining), developments in corporate governance and more specifically tax governance, empirical research on the (changing) level of compliance and the correlation with cooperative compliance.

- **Concrete expected changes**:

TA in the future will develop as society develops. More specifically I think the tax return, certainly in its present form, will disappear. Country by country reporting in the financial accounts will make it obsolete. This is one of the reasons that tax education must be more integrated with financial reporting. Also transparency issues like country by country reporting will make more comparative research possible. Tax education will have to focus more on IT skills, internal controls and the similarities with financial accounting (rather than stressing the differences). Tax audits will become more integrated with audits by other government agencies[33] and external audits. Tax audits will also become more international as tax authorities of various jurisdictions will increasingly work together and/or will increasingly rely on each other's work. Transparent and public tax principles will become increasingly important for companies to have and to adhere to under pressure of governments and media (extrinsic motivation). I hope this will eventually lead to intrinsic motivation. The legislative process should be supra nationally coordinated and the practical implementation for companies as well as tax authorities should be an integral component of the legislative process. I expect that some form of further regulation of the TCF will take place, preferably on an international level, but I do not expect it to be very detailed.

[33] Such as the DNB and AFM. See for a recent example of interest for taxation by DNB a paper for Dutch Parliament *https://www.tweedekamer.nl/vergaderingen/commissievergaderingen/details?id=2016A02393*

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